



Will Wong, RingCentral, Inc. – Vice President, Investor Relations

Thank you. Good afternoon and welcome to RingCentral's third quarter 2024 earnings conference call. Joining me today are Vlad Shmunis, Founder, Chairman, and CEO, and Vaibhav Agarwal, Senior Vice President of FP&A and Chief Accounting Officer. Our format today will include prepared remarks by Vlad and Vaibhav, followed by Q&A.

We also have a slide presentation available on our investor relations website that will coincide with today's call, which you can find under the Financial Results section at ir.ringcentral.com.

Some of our discussion and responses to your questions will contain forward-looking statements regarding the Company's business operations, financial performance, and outlook. These statements are subject to risks and uncertainties, some of which are beyond our control, and are not guarantees of future performance. Actual results may differ materially from our forward-looking statements, and we undertake no obligation to update these statements after this call. For a complete discussion of the risks and uncertainties related to our business, please refer to the information contained in our filings with the Securities and Exchange Commission, as well as today's earnings release.

Unless otherwise indicated, all measures that follow are non-GAAP with year over year comparisons. A reconciliation of all GAAP to non-GAAP results is provided with our earnings release and in the slide deck. For certain forward-looking guidance, a reconciliation of the non-GAAP financial guidance to the corresponding GAAP measure is not available as discussed in detail in the slide deck posted on our Investor Relations website.

With that, I'll turn the call over to Vlad.



Vlad Shmunis, RingCentral, Inc. – Founder, Chairman, and CEO

Before I discuss our results and highlights from the quarter, I'd like to provide a management update.

I want to extend a warm welcome to Abhey Lamba, who we announced today as our new Chief Financial Officer. Building from his start as a software engineer at Bentley Systems, Abhey is a seasoned finance and technology leader with over 30 years of experience. Abhey joins us from Amazon Web Services, where he is Vice President of Finance for Global Infrastructure, including Gen AI investments. Prior to Amazon, he held finance leadership roles at Cisco Systems and Autodesk. In his various roles, he has driven growth and profitability for multi-billion-dollar businesses. Previously, he served as a sell-side analyst on Wall Street for over 15 years, where he covered enterprise technology, hardware and SaaS companies at UBS, ISI Group and Mizuho Securities. Abhey will join in his new role in the coming weeks.

I would also like to sincerely thank Vaibhav Agarwal, our SVP of FP&A and Chief Accounting Officer, for his valuable contributions to our company during this transition. His selfless dedication and outstanding leadership ensured that we did not miss a beat during this transition period. Vaibhav will partner with Abhey and myself as we scale the company in the next stage of growth.

Now moving to results.

We had a solid third quarter. Revenue was above our guidance range. Our outperformance was driven by continued strength in our core UCaaS market combined with strong traction from our new products, in particular RingCX. We also delivered on our profitability goals, including achieving GAAP operating profitability in the quarter. The combination of strong growth and operating margin expansion, a material reduction in SBC, and the return of capital via buybacks has driven a 56% year-over-year increase in free cash flow per share this quarter.

Our results demonstrate we are executing against our strategic priorities. They are:

- One, solidifying our UCaaS leadership by infusing AI across our entire portfolio amongst other initiatives.
- Two, expanding TAM through new AI-powered products. These include:
 - RingCX - our native, AI-powered CCaaS solution;
 - RingSense - our conversation intelligence offering; and
 - RingCentral Events - our virtual and hybrid events platform.
- And third, broadening our reach by nurturing and growing our large and diverse partner network and expanding into new geographies.

We believe these priorities will drive long-term, profitable growth through increased wallet share, improved retention and more efficient new logo acquisition.

Now, let me share more about each priority and how we performed against it during the quarter.



First, solidifying our UCaaS leadership. We have built a leading business communications platform grounded in TIP, which stands for Trust, Innovation and Partnerships. On Trust. We've been delivering five nines or better reliability for over 6 years. Customers of all sizes including some of the world's best-known brands choose us because of our robust feature set, ease of deployment and use, and carrier grade reliability - all built on our secure, standards compliant, and highly scalable, global platform.

This continues to be a key differentiator and a competitive advantage for us, which is why we have been named by Gartner for the tenth consecutive year as a Leader in the 2024 Magic Quadrant for UCaaS report. Core to this recognition is our leadership in voice. Voice continues to be mission critical. We see this in our user base, where voice minutes per user remains consistent with historical trends. This is supported by a recent IDC survey which concluded that "78% of organizations agree that voice calling will remain a priority mode of communication in their employee and customer interactions."

Given our leadership in voice, Enterprises are choosing RingCentral's business phone platform to complement their use of Microsoft Teams messaging and video. Teams customers turn to RingCentral for advanced phone capabilities that are not available with Teams. These include but are not limited to SMS, fax, call monitoring, call queue management, IVR, rich communication APIs, broader global reach, native integrations with major CRMs, and robust analytics and reporting.

Based on these advantages and our deep integration with Teams, this quarter we booked a \$1 million plus TCW win with a large European healthcare provider who is also a Teams customer. This customer will deploy us in their 35 plus offices across Europe.

Voice is the primary mode of business communication, and AI is a tailwind for voice. Businesses can now unlock the power of their voice conversations as a rich source of data that enables more insights and smarter decisions. This is why we recently announced RingCentral AI Assistant, which is now included at no additional cost for all RingEX customers. RingCentral AI Assistant automatically generates detailed, real-time notes for voice calls; helps write and translate texts; and summarizes meetings to create action items, reducing time spent on mundane tasks and freeing up employees' time for more critical work. Omdia Research recently cited the transcription by RingCentral AI Assistant as "amazingly accurate". A long time RingCentral customer, the Detroit Pistons, is already implementing AI-powered note-taking for their team meetings and strategy sessions. Paul Rapier, their VP of IT, said that "it has been a game-changer for the Pistons' operations. Previously, we worried about missing crucial details, especially during fast-paced, pre-game preparations. It has significantly enhanced our ability to stay organized and aligned. This technology isn't just improving our administrative efficiency; it's giving us a competitive edge by ensuring no valuable insight or strategy falls through the cracks."

To further our competitive moat, we recently achieved a significant milestone by receiving a PAN-India license from the Indian Department of Telecommunications. This authorization allows us to



operate across all 22 telecommunications circles in India, making us the first cloud provider to deliver fully compliant UCaaS and CCaaS solutions throughout the country. Multinational organizations can now seamlessly connect their global offices with Indian branches, facilitating efficient communication and collaboration.

Now let's move on to the new products.

First, our new native CCaaS product, RingCX. IDC recently highlighted that over 80% of organizations believe it is important that their UCaaS solution includes CCaaS capabilities. Benefits of a joint UCaaS & CCaaS solution include improved collaboration between call center agents and the rest of the organization, resulting in overall improved customer experience, integrated conversation intelligence, unified usage analytics, a better overall user and administrator experience, and uniform SLAs for all internal and external communications.

RingCX is a modern, AI-powered, omnichannel CCaaS platform, offering native conversation intelligence and quality management in over 20 digital channels, in addition to voice and SMS. It is seamlessly integrated with our industry leading RingEX platform, and further differentiates on combining ease of deployment and use with depth of functionality, reliability and security.

Based on these strengths, this quarter we booked a \$1 million plus TCV deal with one of North America's largest manufacturers of automotive replacement tires that will be deploying RingEX, RingCX and RingSense across their entire international footprint.

As an additional proof point of RingCX's ability to scale, including more advanced use cases, we have also recently moved the entire RingCentral customer service team of over 1,000 support agents to RingCX. This was done cost efficiently, in a few short weeks, and without disruption.

We now have over 500 customers on the platform, up over 45% sequentially. In addition to strong customer growth we are also seeing strong ARPU expansion, which was up sequentially. The RingCX AI Quality Management Add On has been a key driver of this ARPU expansion, with a nearly 50% attach rate to new bookings in the quarter.

AUTOPAY, an auto loan specialist, said "Since we migrated to RingCX, we estimate a 20% time savings for customer success reps due to sophisticated AI-based technology that RingCX delivers."

To further enhance the value proposition of RingCX in the mid-market and enterprise segments, today we have announced a strategic partnership with Verint. Through this partnership, RingCX customers will be able to leverage Verint's leading WEM and CX automation solutions, which complement RingCentral's native AI capabilities. This is to enhance employee productivity and improve customer experiences, ultimately driving competitive advantage and operational efficiency to our customers.



With the ability to address a full range of use cases, we will be prioritizing our native CCaaS platform, RingCX. The strong traction we are seeing with RingCX has validated its value proposition in the market. As RingCX grows its base, it has the potential to capture a meaningful share of the multi-billion-dollar CCaaS TAM with owner economics for RingCentral.

Second, RingSense, our conversation intelligence platform that was formerly called RingSense for Sales, now has over 1,200 customers, up over 45% sequentially. The RingSense customer base and use cases are diverse. For example, legal firms are using it to simplify case management, and healthcare organizations such as REE Medical are using it to automatically review approximately 75,000 calls a month for specific keywords versus previously only being able to manually review a few hundred calls per month.

And third, our virtual and hybrid events solution, RingCentral Events, added over 100 new customers during the quarter. These included Trimble, a Fortune 500 technology company. Trimble picked RingCentral Events for its ability to easily create high production quality branded events. We also renewed relationships with key RingCentral Events customers such as Block, DHL, eBay, NYU, Rutgers and TELUS, amongst others.

In February of this year, we set a target of achieving at least \$100M of exit ARR from our new products by the end of 2025. We are encouraged by our results so far, and believe we are well on our way to achieving this target.

Now on to Partnerships.

Our differentiated go to market includes a large, direct salesforce, top global service providers, or GSPs, and a large partner and reseller network. This allows us to have access to multiple customer groups, geographies and verticals. It is an important part of our competitive moat that allows us to successfully scale our multi-product business. Let me give you some highlights from the quarter.

First, GSPs. Our GSP business again grew faster than our overall business. This network of GSP partners and the deep engagements that we have built with them on both product and go-to-market are unmatched by UC and CC peers. A great example of this deep engagement is our 10 year plus partnership with AT&T, the nation's premier fiber, fixed wireless and wireless provider, which we recently renewed.

We are also leveraging our large GSP network to grow internationally. We recently added Optus, a leading service provider in Australia, and are now seeing early traction together. We also continue to see success with Vodafone, as well as British Telecom and TELUS.

Leveraging our unique GSP network is also a key opportunity and differentiator for RingCX growth. Vodafone, Cox and Zayo have already chosen RingCX as the CCaaS solution to bring to their diverse customer bases, and we are optimistic of further progress with these and other key partners on this front.



In summary, we had a strong quarter in delivering against our strategic priorities. RingCentral is a proven leader in UCaaS, where the opportunity remains large, and our new CCaaS, AI, and Events products are showing good early traction. We are also executing on our efficiency initiatives, which is resulting in expanded profitability and free cash flow, as well as reducing SBC. We are on an exciting path, and I am confident that we can continue to execute in the quarters and years ahead.

With that, I would like to again thank Vaibhav for his outstanding contributions, and will now turn the call over to him to discuss our financial results in more detail.



Vaibhav Agarwal, RingCentral, Inc. – SVP FP&A and Chief Accounting Officer

Thanks Vlad.

Now, I'll provide highlights from the third quarter, and then discuss our business outlook for the fourth quarter and full year.

In 3Q, we executed well across all our key financial metrics - revenue growth, operating profit, SBC and share count reduction - and are raising our full year revenue and free cash flow guide. In Q3, subscription revenue of \$583 million was up 10% year over year, solidly above the high end of our guidance range.

ARR of \$2.48 billion was up 9% year over year on a reported and constant currency basis. On a sequential basis, currency was a moderate tailwind. By customer group, Enterprise ARR rose 11%, with both mid-market and small business up 8% versus last year. As Vlad noted, new products, in particular RingCX, continue to perform well, with sequential ARR growth in 3Q consistent with 2Q.

Moving to profitability. I'll be referring to non-GAAP results, unless otherwise noted. Subscription gross margin was 81%, down slightly sequentially, as we invest in infrastructure to support the strong growth of our new products as they scale. Overall ARPU remained over \$30, with new product ARPU meaningfully higher than overall ARPUs. Over time, as the contribution from new products grows and its penetration within our large base increases, we expect new products to be accretive to overall ARPU.

Operating margin rose approximately 2 points year over year to 21.0%. The year over year increase is driven by continued spending discipline and focus on operating efficiency. Sales and marketing expense as a percent of total revenue declined 220 bps to 39.0%, as we continue to drive down costs in the sales and marketing organization and optimize for higher margin routes to market.

Overall, we view operating margin expansion in conjunction with reducing stock-based compensation, as both ultimately drive higher free cash flow and free cash flow per share.

During the third quarter, we generated free cash flow of \$105 million, up 51% versus last year. Free cash flow margin was 17.3%, up 480 basis points year over year. In addition to continued operating leverage and disciplined spending, free cash flow has also benefited from working capital efficiencies.

Moving to stock-based compensation. Stock-based compensation was \$85 million, or 14% of total revenue, down 630 bps versus last year.

Through the first three quarters of 2024, net new share grants are down more than 60% versus last year, and we are on track to exceed our goal to reduce share grants by 50% of 2023 levels.



The reduction in grants is important, as the lower number of shares granted and lower grant value will result in continued improvement in SBC going forward.

Importantly, free cash flow again exceeded SBC, and is a reflection of our discipline in meaningfully reducing stock-based compensation while significantly growing free cash flow.

Moving to our balance sheet and capital allocation.

We will continue to employ a balanced and disciplined approach to returning cash to shareholders through both debt repayment and share repurchase.

Net debt to adjusted EBITDA improved to 2.3x, down from 3.0x last year, as we meaningfully increased our profitability.

Consistent with what we shared last quarter, we plan to address our \$161 million of 2025 Convertible Notes with available cash and cash flow.

In Q3, we secured an additional \$275 million delayed draw commitment to our Term Loan A, bringing total commitments to \$350 million. We have until May 2025 to draw down on this commitment. We plan to address our Convertible notes coming due in March 2026 with this commitment plus the free cash flow we expect to generate between now and March 2026. As part of deploying a dynamic capital allocation approach, we continue to target reducing our gross debt from \$1.5 billion today to no more than \$1 billion before the end of 2026. Note our liquidity as of Q3 stands at \$788M, which is comprised of cash on hand plus the undrawn commitments on our Term Loan A and Revolver.

We believe that share repurchase continues to provide an attractive relative return. In Q3, we repurchased 2.6 million shares for \$83 million. So far in 2024, we have repurchased 7.5 million shares for \$245 million and have approximately \$243 million remaining on our authorization at September 30, 2024.

Our recent share buybacks combined with continued discipline on stock-based compensation will result in our fully diluted share count continuing to decline further. We are making good progress, with fully diluted share count declining by 1% sequentially and 3% versus last year. Going forward, we plan to continue to at least fully offset dilution from SBC via buybacks, all while preserving financial flexibility with respect to excess cash. Overall, our results this quarter demonstrate our ability to execute on our plan to deliver growth from our core and new products, expand margins through continued spend efficiencies, reduce stock-based compensation and deploy a balanced capital allocation approach that includes share repurchase and debt paydown. With this strategy, we believe we can continue to strengthen our financial profile, and believe we are well positioned for the future.



Now, let me turn to guidance. Embedded in our guidance is the expectation that the macro environment and the current business trends remain relatively stable, with no further material improvement or deterioration in conditions. With that backdrop:

For the fourth quarter of 2024, we expect:

- Subscription revenue growth of 7% to 8%
- Total revenue growth of 7%
- Non-GAAP operating margin of approximately 21%, and
- Non-GAAP EPS of \$0.96 to \$0.97, based on a fully diluted share count of 92.5 to 93.0 million shares.

For the full year, we are raising our revenue outlook.

- We now expect subscription revenue of \$2.295 billion to \$2.297 billion, representing growth of 9%, and total revenue of \$2.397 billion to \$2.399 billion, representing annual growth of 9%.
- We continue to expect a non-GAAP operating margin of 21%, as we balance profitability with reinvesting back into the business. Importantly, we now expect stock-based compensation of \$350 to \$355 million, down from \$370 to \$380 million previously.

We also expect:

- Non-GAAP EPS of \$3.69, up from \$3.62 to \$3.67, driven in part by our lower share count outlook, as we now expect 94.5 million fully diluted shares outstanding in 2024, down from 95 to 96 million shares previously.

Regarding free cash flow, we now expect free cash flow of \$400 to \$405 million, up from \$395 to \$400 million. Our outlook includes capitalized expenditures of \$85 million, cash paid for interest of \$60 million, restructuring and other payments of \$27 million, as well as \$25 million of cash received from certain strategic partners.

As Vlad noted, prioritizing RingCX will be a key long-term growth driver with a significantly better margin profile given its owner economics. We are excited about the opportunity to meet the emerging customer demand for our fully scaled, native UC+ CC solution. RingCX is our own proprietary technology that will allow us to innovate faster and better serve our customers' needs. While it's still early for RingCX, we believe that over time its bookings will eventually meet or exceed those of RingCentral Contact Center bookings at its peak levels.

In summary, we had a good quarter. We are executing against our strategy of delivering growth from our core, expanding our addressable markets through our new products, and driving a strong financial profile while reducing our reliance on third parties for core competencies that will result in continued free cash flow generation while materially lowering our share count. We believe this strategy will maximize returns for all stakeholders.

With that, let's open up the call for questions.